No. 16097.

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

ROBERT E. AUSTIN and MARIAN H. AUSTIN,

Petitioners,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

On Petition for Review of the Decisions of the Tax Court of the United States.

PETITIONERS' REPLY BRIEF.

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TABLE OF AUTHORITIES CITED

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PETITIONERS' REPLY BRIEF.

There seems to be no difference of opinion as to the facts. However, there is a difference of opinion as to whether those facts sustain a finding that the real estate sold by petitioner in 1950, 1951 and 1952 was held by him "primarily for sale to customers in the ordinary course of his trade or business."

Careful reading of the authorities cited by respondent reveals that in each case there were activities that "resulted in trade or business" or "constituted conduct of a real estate business." For the purpose of showing the

court that petitioner's activities were such as to result in such trade or business respondent sets up six activities (Resp. Br. pp. 21, 22) as follows:

Taxpayer:

1. Handled the negotiations involved in a large portion of the sales (some prospective buyers were brought to him by brokers who were aware that he had property for sale) [R. 43, 47, 77, 82, 83];

2. Conducted all of the legal and paper and other detailed work personally [R. 78-79];

3. Handled the originating and collection details of numerous installment sales [R. 23, 43, 78];

4. "Borrowed a good deal of money from banks * * *" to make improvements and to make up mortgages [R. 81];

5. Arranged for loans to finance installment purchases which was deducted as a business expense [R. 26, 81; Joint Exs. Nos. 1-a, 2-B, 3-C, 4-D]; and

6. Constructed at least two or three buildings, to make other improvements, and carried on a substantial rental business. [R. 15, 61-62, 73, 83-84.]

We will discuss each of these activities.

Discussion of Activities Relied Upon by Respondent.

1. The evidence shows that negotiations consisted simply of an inquiry by a possible buyer of the price and terms as to which a particular lot might be purchased, and the answer by taxpayer furnishing that information. [R. 71.] Taxpayer's time consumed in answering such an inquiry either by telephone or by postal card was infinitesimal. [R. 71.] There was no negotiation on any sale other than the inquiry about the price and terms and the answer giving it. Respondent's citations of the

record do not sustain the theory that there were important or extensive or any negotiations.

2. The evidence shows that whaever legal work there may have been, the filling out of a deed, trust deed and note, was sometimes taken care of by taxpayer, but frequently in the escrow offices. [R. 78, 88.] In any event that service has none of the elements of carrying on a business. The sale if made and the business done, if any, was all completed before the time arrived to fill out the papers carrying it into effect, and such clerical activity could in no sense be construed as carrying on a real estate business.

3. It does appear that taxpayer received or collected payments made by purchasers for real estate sold, but this like filling out blanks necessary to convey the title and evidence the unpaid portion of the purchase price, if any, in no sense constitutes conducting a real estate business, or puts the taxpayer who received the payments in the position of carrying on a trade or business, or constitutes the persons making the payments customers.

4. The fourth activity that of borrowing money from banks to make improvements and to make up mortgages would certainly in no sense be either conducting a real estate business or put the borrower in a trade or business. Every investor at one time or another borrows money to develop or increase his investments. The record contains the following testimony of taxpayer "I borrowed a good deal of money from the banks . . . I made some improvements and found myself short of money, and went to the bank and borrowed money to make up the shortage." [R. 81.] No other evidence appears in the record on that subject. The charge here involves the specific properties sold in 1950, 1951 and 1952. There

was no money borrowed on those properties or mortgages made up, and borrowing money to improve other properties shown to be substantial rent producers could not constitute holding these properties primarily for sale to customers.

5. Nowhere in the record do we find any evidence that taxpayer arranged for loans other than above, or arranged to finance installment purchasers, or that any expense was incurred for such purpose, or was deducted as business expense.

6. The record does show that taxpayer constructed buildings on property owned by him, but no sale of any such property appears in the record here. Certainly the construction of buildings by the taxpayer would be an investment, but certainly could not be construed as carrying on a real estate business.

Reply to Other Portions of Respondent's Brief.

In no case does it appear that any property acquired by taxpayer was bought as part of a plan to sell it in the process of carrying on a real estate activity. Every purchase was made under conditions that indicated that the taxpayer would have to wait for growth in the value of the property to get the original investment out of it.

A merchant or dealer does not rely on potential growth for his business. The shoe merchant buys shoes today expecting to sell them next week, or next month in a market where values are probably the same as today. Then he buys more shoes.

In the big purchase of 102 lots from the City taxpayer was confronted with the requirement to pay the City's loss of $2,000.00 to $2,500.00, or to buy the lots. [R. 42.] He chose the later in the hope that time would in-

crease the value of the lots and that he might get his money back and make a profit. [R. 82.] The hope was not based on any customers he had or expected to have but on the possibility that there would be a growth in value of the property.

Respondent's brief suggests that the taxpayer kept on hand a substantial inventory of lots and that the supply was constantly replenished, as indicating that the taxpayer was in the business of buying and selling lots. The following is a table showing the number of lots purchased and sold each year, as shown by stipulations appearing on page 14 of the Record. We have added an extra column, computed from the table, which shows the number of lots owned by taxpayer at the end of each year.

Year	Number of Purchases	Number of Parcels Acquired	Number of Sales	Number of Parcels Sold	Number Unsold at End of Year	
1943	2	2	....	....	2	
1944	2	5	....	....	7	
1945	3	69½	....	....	76½	
1946	6	64½	24	38	108	
1947	6	16	8	13	106	
1948	3	9	22	26	89	
1949	1	1	7	15	75	Left on hand at beginning of 1950
1950	1	1	5	11	65	
1951	....	....	8	23	42	
1952	....	....	10	14	28	
	24	168	84	140		

This computation effectively refutes the suggestion that taxpayer kept an inventory of lots on hand. In this connection all of the lots purchased up to and including 1946 were purchased before any sales were made in that year, so that we are entitled to say that of the total of 168 lots

acquired in the 10-year period all but the last 27 were purchased before any lots were sold. Thus before the sales began, in the latter part of 1946, taxpayer had on hand 141 lots. The evidence shows that the 132 lots which constituted the bulk of the lots acquired were purchased at a time when the City of Manhattan Beach had failed to sell them at its auction sales, and The Amaranth Land Company was unable to dispose of its lots and sold twenty-one of them for $2,400.00, and the Pacific Land and Title Company sold nine of its lots, part of those listed above, for $575.00.

The Commissioner's brief says that Manhattan Beach was a fast growing city, but that was after these purchases were made. The city was small in 1944-1945 when the guaranty arrangement for 102 lots was entered into. [R. 41.]

The evidence shows that in 1946 people became interested in lots (that was after the war when people engaged in war activities began to get back to civilian life.) [R. 80.] The evidence shows that from this time on there was a brisk demand for lots; that people wanting them were hunting for them by searching the Assessor's records and otherwise, but no such demand for lots existed or was suspected by anyone until after taxpayer had acquired 141 lots purchased by him in 1946 and before. [R. 42.] Of the 168 lots purchased in the ten-year period before the court only 27 were purchased after demand for lots began to appear. The record shows that 132 of the 134 lots bought in 1945-1946 were 102 from the City of Manhattan Beach, 21 from Amaranth Land Co. and 9 from Pacific Land and Title Co. [R. 45, 53.]

The 27 lots bought after 1946 included:

6 lots bought and used for a home;

4 lots bought and used for a subsequent home. [R. 21-24.]

6 lots for parking and waste disposal for lots already owned. [R. 61-62.]

2 lots bought, improved and still owned as an investment. [R. 64.]

1 taken in payment of a debt. [R. 64.]

2 bought from a friend in distress. [R. 64.]

2 parcels constituting 125 acres on a mountainside far removed from Manhattan Beach. [R. 57.]

2 given back by a young married woman who had been a member of taxpayer's household for years, for whom they had been bought as a financial assist. [R. 59-60.]

In the three-year period under consideration petitioner bought one lot, sold 48 lots, had 75 lots at the beginning and 28 lots at the end. (See table.) He made 23 sales in the three years on an average of one in seven weeks.

Petitioner made many installment sales. [See R. 14, 15; stip. 5; R. 88.] This further emphasizes the investment nature of the holdings and sales. He thereby received interest. The real estate investments were transmuted into investments of equal value in the form of interest bearing promissory notes secured by the title of the land sold. Petitioner did not receive cash with which to replenish his stock.

A dealer must sell his merchandise for cash so that he may purchase stock to replace that which is sold. There

were no replacements in this case, simply selling such portions of the original investment as were not improved for permanent income.

Respondent relies heavily on the proposition that the ultimate question is the purpose for which property acquired is held at the time of sale. He argues that because the lots were acquired with the hope of making a profit and were sold for a profit that they were being held for sale. From this he jumps to the conclusion that the sales were to customers in the "ordinary course of taxpayer's trade or business."

A hope when a purchase of property is made that the property may at some later time be sold at a profit will not transmute a long time investment in land into a business of buying and selling real estate, or change a capital transaction into an ordinary business profit or loss. (*Palos Verdes Corp. v. United States,* 9 Cir., 201 F. 2d 256, 258; *Harriss v. Commissioner of Internal Revenue,* 2 Cir., 143 F. 2d 279, 280-281; *Phipps v. Commissioner of Internal Revenue,* 2 Cir., 54 F. 2d 469.)

We submit that if lots were originally acquired as an investment their character as such would not change merely because they were ultimately sold as they had to be at some time or other.

The Record [p. 23] shows that of the 11 lots sold by petitioner in 1950 one was acquired in 1943 (held 7 years); four in 1945 (held 5 years); and six in 1946 (held 4 years); that of the 23 lots sold in 1951 one was acquired in 1945 (held 6 years); 20 in 1946 (held 5 years), and two in 1948 (held 3 years); that of the 14 lots sold in 1952 two were acquired in 1944 (held 8 years); four in 1945 (held 7 years); six in 1946 (held 6

years); one in 1947 (held 5 years), and one in 1949 (held 3 years).

The statute (26 U. S. C., 1952 ed., Sec. 117(j)) by virtue of its six months requirement recognizes that there may be investments even with a holding of property for six months or less. However, in order to be accorded capital gain treatment the holding must be for more than six months.

In petitioners' case, at the time of sale the property was held by him for the same purpose it was held when it was acquired, to-wit, an investment. The fact that purchasers came along and took the property off of his hands does not change these people into customers and the investor into a dealer holding his investments primarily for "sale to customers in ordinary course of business." With respect to the interpretation of the statute, the words and phrases, "trade or business", "ordinary" and "customers" are to be construed in their ordinary and not in an artificially created meaning (*Yunker v. Commissioner,* 6 Cir., 256 F. 2d 130, 133.) To be engaged in the real estate business means to be engaged in that business "in the sense that term usually implies". (*Dillon v. Commissioner,* 8 Cir., 213 F. 2d 218, 220; *Yunker v. Commissioner,* 256 F. 2d 120, 132.) We submit that the mere fact that property is sold, whenever that may be, does not change what has been an investment into a business.

Counsel speaks disparagingly of the testimony that taxpayers were motivated by altruistic, civic and moral purposes in some of the lot acquisitions described in the testimony. Aren't such motives present in a very large part of the country's business today? In this general area thousands of people devote large amounts of time and spend considerable sums of money on projects of

altruistic, civic and moral natures such as schools, churches, chambers of commerce, civic associations, service clubs and various governmental activities. For instance the Metropolitan Water District of Southern California, which has constructed and operated the Colorado River Aqueduct, rated by the American Society of Civil Engineers along with the Panama Canal and such others as one of the seven engineering wonders of the United States, is the product of the labors of many men, including the present Board of Directors, who devoted great amounts of time and money to the creation and development of the idea matured into the district, not one of whom ever received a cent of salary or personal compensation except the satisfaction derived from the community benefit which accrued from their efforts and the opportunity to live in a community whose atmosphere, living and business conditions had been improved by their labors.

Is it too much to believe that a lawyer who had been practicing law in a great city for more than thirty years should spend $574.00 to buy nine lots, two of which were needed in the promotion of a park in a little city in which he lived; or that he might join with others in an effort to improve the economic condition of his city by helping to get hundreds of lots which had been deeded to the State for non-payment of taxes back on the tax rolls; and that in connection with such a project he might find himself obligated to buy and actually buying 102 lots of those left on the hands of the City after the promotion had failed; or that he in assisting the family of a deceased friend and client might buy 21 unsaleable lots for $2,400 to help them; or that he might buy two lots to give a financial assist to a young married woman who had been a member of his household from childhood? We think

that thousands of people are making such contributions to others or the general welfare every day. The point here is were the lots acquired as part of the development and prosecution of a real estate business? The fact that no sales were made during the time when the bulk of the property was acquired, and that none were bought for sale when sales were being made would seem to answer that question.

We submit that the ultimate finding of fact of the Tax Court that the lots sold by petitioners were held by them primarily for sale to customers in the ordinary course of trade or business is clearly erroneous, and that the decision based thereon should be reversed.

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